THE REGULATION OF TRUSTEE GOVERNANCE IN AUSTRALIA: **TIME FOR A RETHINK?**

Workshop 1: Regulation of Schemes / Regulatory Approaches
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Abstract

On 30 June 2010, the final report of the *Review into the Governance, Efficiency, Operation and Structure of the Superannuation System* (the **Cooper Review**) was delivered. The Review was tasked with examining the governance, efficiency and operation of Australia's superannuation system. In December 2010, the Federal Government released its response to the final report, and indicated its support for 139 of the 177 recommendations.

My contribution to the workshop will primarily examine the proposals relating to "trustee governance" in Australia and the role to be played by the Australian Prudential Regulation Authority (**APRA**) and the Australian Securities and Investments Commission (**ASIC**) in regulating the activities of trustee boards and their directors. I will consider this governance issue in the context of a broader debate about financial services regulation in Australia.

This paper is divided into 5 parts and examines the following issues:

Part 1. Shortcomings of the current regulatory arrangements and the twin peaks model of regulation in Australia;

Part 2. The proposal to establish a new office of "trustee-director" in the legislative regime;

Part 3. Regulatory design principles and whether *prescriptive* statutory duties sit comfortably with *proscriptive* general law duties for trustees;

Part 4. The appropriate content for a code of trustee governance; and

Part 5. What financial services regulation should look like in Australia.

Part 1. Shortcomings of current regulatory regime and the twin peaks model

The Australian financial regulation system is divided along the functional distinction of prudential regulation and securities and market supervision. Prudential regulation is carried out by the Australian Prudential Regulation Authority (**APRA**), and securities and markets supervision is carried out by the Australian Securities and Investments Commission (**ASIC**). Both are statutory authorities created by Acts of Parliament,[1] and are independent bodies, although APRA in theory can receive policy direction from the Treasury.[2] The other regulators of note are the Reserve Bank of Australia (**RBA**), which is responsible for monetary and banking policy,[3] and the Australia Competition and Consumer Commission (**ACCC**), which promotes competition and fair trade in the marketplace and regulates anti-competitive conduct. The Australian Taxation Office (**ATO**) also plays a significant role in the financial services system (in particular, the superannuation industry).

This 'twin peaks' model of financial regulation was introduced following the *Financial Services Reform Act 2001* (Cth) (**FSR**). This reform was recommended by the Wallis Report of 1997,[4] the result of an inquiry into the future of Australian financial regulation in the wake of the deregulation of the financial industry which occurred in the early 1980's. The FSR reform resulted in the merger of the previous three regulators into the two current regulators, ASIC and APRA.[5] The goal of the reform was to identify the best overall framework for the delivery of regulation, and to propose ways in which the regulation conducted would enhance competition and efficiency. The reforms resulted in the current system, the robust nature of which is widely acknowledged as a primary reason for the comparatively easier passage through the global financial crisis of the Australian economy.[6] However, despite the evident recent overall success of the system, the author argues that certain shortcomings are still evident, and may be difficult to remove entirely. The first is the regulatory overlap which exists as the result of the activities of ASIC and APRA, and causes inefficiency in entities subject to dual regulation. The second issue is the inherent tension that exists between the two regulators as a result of their inherently different mandates.

A: Regulatory Overlap

The most obvious shortcoming in the current Australian system is the regulatory overlap that exists between its two regulators, and the consequential problems that arise. To

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[1] *Australian Securities and Investments Commission Act 2001* (Cth); *Australian Prudential Regulation Authority Act 1998* (Cth).

[2] *Australian Prudential Regulation Authority Act 1998* (Cth), s 12; it should be noted that this power has not been exercised to date, and would only be exercised in grave circumstances: see *Australian Prudential Regulation Authority*, "Memorandum of Understanding between the Treasury and APRA", available at <http://www.apra.gov.au/AboutAPRA/upload/MoU-Treasury.pdf>.

[3] *Reserve Bank Act 1959* (Cth), s 10.

[4] Commonwealth of Australia, *Financial System Inquiry Final Report, March 1997*, available at <http://fsi.treasury.gov.au/content/FinalReport.asp>.

[5] Ibid, 31, 42.

[6] The Association of Superannuation Funds of Australia Limited, *ASFA Submission – Super System Review – Phase One: Governance* (2009), 16; Australian Institute of Superannuation Trustees, *AIST Submission – Review into the governance, efficiency, structure and operation of Australia's Superannuation System* (2009), 21.

understand the nature and extent of the overlap, the scope of each of the regulators must be highlighted. ASIC regulates 1.77 million corporations, 4,874 financial services businesses and 16 financial markets.[7] Its mandate is broad, being responsible for consumer credit regulation, market regulation and financial services regulation in addition to administering and enforcing the law in these areas.[8] APRA is the prudential regulatory body of the financial services industry, and is concerned primarily with risk management and setting prudential standards that ensure the Australian financial system remains stable, competitive, and efficient. APRA oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and most members of the superannuation industry. ASIC is larger in terms of staff and budget, and unlike APRA, ASIC regulates the full spectrum of corporate entities. However, as the finance and insurance sectors comprise 10.7% of the Australian GDP[9] and its institutions hold some $3.7 trillion in assets,[10] APRA nonetheless exercises considerable influence.

The regulatory overlap exists because ASIC and APRA regulate the same financial entities. Certain activities are actively regulated by both regulators, often with very different requirements. The following are examples pertinent to the superannuation industry:

- In the superannuation industry, entities are required to comply with both the ASIC Australian Financial Services License (**AFSL**) requirements, and also with the APRA Responsible Superannuation Entity (**RSE**) licensing requirements;
- Data collected by trustees often has to be provided to both regulators, which effectively doubles the administration and time spent collecting. In the superannuation industry this cost is often borne directly by beneficiaries.

Further confusion can result when in other circumstances, almost identical structures are regulated by different regulators based upon a seemingly superficial distinction. For example, superannuation trusts and managed investment schemes operate under a trust structure, must be licensed, and are subject to similar capital requirements, yet the former is regulated by APRA and the latter is regulated by ASIC.

It should be unsurprising that this overlap in regulation causes inefficiency in the form of increased compliance costs, and also can result in regulatees growing confused, and interpreting the regulation as unreasonable. This can eventually result in the regulation actually becoming counterproductive, because if regulatees perceive the regulation to be unreasonable, they may adopt a policy of bare minimum compliance. In the worst case, this may even lead to more regulation, because if the regulatory bodies perceive that their regulation is being ignored, they may attempt to solve the problem by creating

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[7] Australian Securities and Investments Commission, *Annual Report 09-10*, 4, available at <http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC_AnnualReport-2009-10.pdf/$file/ASIC_AnnualReport-2009-10.pdf>.

[8] *Australian Securities and Investment Commission Act 2001* (Cth), s 1(2).

[9] Department of Foreign Affairs and Trade, *Trade at a Glance 2010*, 23, available at <http://www.dfat.gov.au/publications/trade/trade_at_a_glance_2010.html#sect02>.

[10] Australian Prudential Regulation Authority, *About APRA Home*, available at <http://www.apra.gov.au/aboutApra/>.

more regulation.[11] Such a scenario is less than desirable. As Professor John Farrar has noted, we as Australians have “a tendency to over-legislate, and the result is obese and user-unfriendly legislation”.[12] In fact, from 1990 to 2005, the federal government passed more legislation than it had in the previous 90 years since federation.[13]

In general, one of the ways to restrict the detriment that results from overlapping regulation in a multi-regulator model is to stimulate communication and coordination between regulators. Unfortunately, in the Australian system, such cooperative behaviour has not always been apparent. The most infamous instance of a breakdown in communication between APRA and ASIC was the HIH Insurance collapse of 2001. Despite identifying the company as being “poorly run”, and requiring a greater disclosure of information, it was not APRA but the HIH board which ultimately appointed liquidators when the company became insolvent.[14] At the time of the collapse, HIH was the second largest insurance company in the nation,[15] and it still remains the biggest corporate collapse in Australian history, with an estimated liability of $5.3 billion.[16] Owen J, the chair of the Royal Commission into the collapse, bluntly stated that “APRA’s performance in supervising HIH was not good”, finding that APRA had failed to appreciate the information it received, and acted either too slowly or not at all.[17] His Honour found ASIC’s involvement in HIH’s affairs equally limited, and found that the reason for this was a policy of separation between the two regulators. His Honour found that “ASIC considered it had little direct responsibility in relation to prudential regulation of insurers: that was APRA’s role...I cannot fault ASIC for assuming that position. It was a view APRA shared.”[18] Both regulators, but particularly APRA, were the subject of considerable criticism after the collapse of HIH. In response to the criticism and the Report of the Royal Commission into the HIH collapse, amendments were made to the *Corporations Act 2001* (Cth) and the regulators adopted new policies to prevent a recurrence of regulatory failure. While some critics have labelled the policy changes adopted as mere “tweaking”,[19] most agree that APRA is now capable of exercising “earlier and more interventionist action”.[20]

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[11] Michael A Adams, Angus Young & Marina Nehme, “Preliminary review of over-regulation in Australian financial services” (2006) 20 *Australian Journal of Corporate Law* 1, 12.

[12] J Farrar, *Corporate Governance in Australia and New Zealand* (2001), 6.

[13] Commonwealth of Australia, *Rethinking Regulation – Report of the Taskforce on Reducing Regulatory Burdens on Business* (2006), 1.

[14] Australian Prudential Regulation Authority, *Media Release: HIH Insurance – APRA’s Role Revisited*, available at <http://www.apra.gov.au/media-releases/01_13.cfm>.

[15] Adams, above n11.

[16] Commonwealth of Australia, HIH Royal Commission, *The Failure of HIH Insurance: Volume 1 – A Corporate Collapse and its Lesson* (2003), 3.7.

[17] Ibid, 34.

[18] Commonwealth of Australia, above n16, 36.

[19] Adams, above n11, 14.

[20] Professor John H. Farrar, “The global financial crisis and the governance of financial institutions” (2010) 24 *Australian Journal of Corporate Law* 227,228, 237; Australian Securities & Investment Commission, *The Integration of Financial Regulatory Authorities – the Australian Experience* (paper presented by Jeremy Cooper to the Securities and Exchange Commission of Brazil 30th Annual Conference, 4-5 September 2006), 6-7.

Whether or not the communication and coordination between ASIC and APRA has improved, it has been identified by the Cooper Review[21] as an area for more improvement. While some of the recommendations are, in the author's opinion, likely to be counterproductive, others have the potential to remove much confusion and uncertainty. An example of one such positive reform is Recommendation 10.2, which proposes that APRA be given a prudential standard-making power for the superannuation industry.[22] Given that APRA already has such a power in respect of every other type of entity it regulates, expanding that power to cover superannuation funds will bring much needed consistency to the prudential landscape. APRA currently has the power to issue guidance to superannuation fund trustees on prudential matters, which the majority of superannuation fund trustees already follow as a matter of good practice, as though the guides were in fact already legally binding.[23] Furthermore, compliance is incentivised, as a failure to comply with the APRA guidelines will result in increased regulatory oversight, and can lead to APRA investigations or conditions being imposed upon licenses. However, granting these guidelines the force of law will remove any uncertainty about whether they ought to be followed, and will allow APRA to make its expectations of trustees in the superannuation industry clearer.

Whether as a result of the twin peaks system itself or as a result of a dearth of communication and coordination between the two regulators, the reduction in regulatory compliance costs envisioned by the Wallis Report has not materialised.[24] The Investment & Financial Services Association (now known as the Financial Services Council) submission to the Cooper Review recommended that "APRA and ASIC need to work more closely to ensure overlap is minimised and that where overlap does exist, the requirements of each regulator are consistent".[25] This was accepted by the Cooper Review, which recommended that "the Government should explore with APRA and ASIC ways in which the two regulators can work more closely together in discharging their superannuation mandates".[26] The Government has given support in principle to the recommendation,[27] and if managed in practice, increased cooperation between the regulators would undoubtedly be beneficial for the industry.

B: Different Agendas

The second shortcoming of the Australian regulatory system is the differing mandates of the two regulators due to their, at times, conflicting regulatory policies. ASIC is concerned with market integrity, which it achieves by ensuring "markets are fair and

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[21] Commonwealth of Australia, *Super System Review: Final Report* (2010) available at <http://www.supersystemreview.gov.au/>.

[22] Commonwealth of Australia, *Super System Review: Final Report – Part Two: Recommendation Packages* (2010), 311, available at <http://www.supersystemreview.gov.au/content/content.aspx?doc=html/final_report.htm>.

[23] Investment & Financial Services Association Ltd, *IFSA Submission – Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System* (2009), 45.

[24] Adams, above n11, 20.

[25] Investment & Financial Services Association Ltd, above n23, 22.

[26] Commonwealth of Australia , above n22, 314-5.

[27] Commonwealth of Australia, *Stronger Super* (2010), 61, available at <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/government_response/default.htm>.

transparent, supported by confident and informed investors and consumers".[28] ASIC has also recently taken on the duty of market supervision as a necessary step on the way to a multi-market environment.[29] This duty was, until very recently, a responsibility of the Australian Securities Exchange. Transparency and informed participation requires the market to be made aware of all pertinent information, which requires continuous disclosure. APRA, on the other hand, is tasked to "establish and enforce prudential regulations" which ensure that "financial promises made by institutions supervised are met".[30] This is a very different goal to that of ASIC.

Former APRA Chairman Dr Jeffrey Carmichael described the difference in agenda between ASIC and APRA using as an example the different agendas of a policeman and a doctor.[31] Using this example he explained that while ASIC is concerned with curbing and punishing human greed, figuratively putting "heads on pikes", APRA is more concerned with maintaining the health, and ultimately preventing the failure, of financial entities.[32] Therefore, while it can be said that consumer protection is a shared mandate of both regulators, ASIC enforces the mandate primarily through punishment of offenders, whereas APRA enforces its standards primarily through rehabilitation.[33]

This broad difference in role between the regulators can be especially trying for regulatees. Having each regulator scrutinising its conduct in furtherance of a different agenda can make compliance difficult for a regulatee, because it may not always be possible to draw a clear line between business conduct (regulated by ASIC) and prudential standards (regulated by APRA). One of the ways ASIC and APRA carry out their mandate is by issuing regulatory standards, yet a common complaint is that "each regulator has different goals and is implementing different legislation". [34] The result is that from the perspective of the regulatee "no regulator has a holistic view of the entire operations of a superannuation fund".[35] Without a streamlined, coordinated approach, compliance is made more difficult and requires extensive administrative activity which in turn makes compliance more costly.

The consequences of the different agendas of the regulators are perhaps most apparent when compelling regulatees to do certain things. For example, both regulators have the power to accept an enforceable undertaking from a person, and both are at liberty to set the terms of those orders.[36] This can lead to individuals or companies giving an

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[28] Australian Securities and Investment Commission, *The Integration of Financial Regulatory Authorities – the Australian Experience* (paper presented by Jeremy Cooper to the Securities and Exchange Commission of Brazil 30th Annual Conference, 4-5 September 2006), 6.

[29] Australian Securities and Investment Commission, *Market Supervision and Surveillance*, available at <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Market%20supervision%20and%20surveillance>.

[30] Australian Prudential Regulation Authority, above n10.

[31] Australian Prudential Regulation Authority, Jeffrey Carmichael, *APRA – the Way Forward* (2002), 4.

[32] Ibid, 5.

[33] Ibid.

[34] Association of Superannuation Funds of Australia Limited, *ASFA Cooper Review Submission – Phase 1: Governance* (2009), 15.

[35] Ibid.

[36] *Australian Securities and Investments Commission Act 2001* (Cth), s 93AA; *Australian Prudential Regulation Authority 1997* (Cth), s 11.

enforceable undertaking on a matter to both regulators simultaneously, but where the terms of the undertaking given to each regulator are widely divergent.[37] It is possible that such orders may conflict, and it is therefore conceivable that if the orders were not given in a coordinated manner, a person or corporation might be punished twice for the same breach. This is made more likely because while ASIC, in the spirit of public disclosure in all things, makes available a register of enforceable undertakings, APRA often keeps secret such undertakings, in order to protect the person or entity from adverse publicity.

C: Twin Peaks versus Single Regulatory Body

Australia's use of the twin peaks system of financial regulation places it globally in the minority, with only the Netherlands currently using a similar model.[38] Much more popular is the use of a single regulatory body, also known as an integrated model of regulation, which is employed in Germany, Japan, Qatar, Singapore, the United Kingdom and Switzerland.[39]

It should be noted that while the twin peaks system carries with it some inherent difficulties, it also has some inherent virtues. One of these is the ability to cope with the tension between securities regulation and prudential regulation. These two purposes can, at times, be directly opposed to one another. For example, if an entity is close to, but not actually in, insolvency, but with good prospects of recovery, a prudential regulator might wish to keep the knowledge quiet to prevent spooking investors. On the other hand, a securities regulator would demand that such information be made public immediately for the purposes of ensuring market integrity. In the case of such a conflict, a two tiered system is better placed to deal with the tension. As Donald Langevoort states, "put simply, those two domains are inherently at odds, and when combined under one roof, securities regulation tends to lose".[40] Another virtue of having separate entities is that the entities possess a high level of autonomy, and are able to independently set about achieving their respective mandates. This separation also increases accountability, as each entity is highly experienced in their field of regulation and has a narrower, well specified mandate.[41] It is qualities such as these which have led to international acclaim of the twin peaks model.[42]

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[37] Adams, above n11: Mr Barry Egan undertook to ASIC not to act as a director or officer of a company holding an Australian Financial Services License for 5 years; at the same time, he undertook to APRA not to occupy any role as a responsible officer in any superannuation entity for 10 years.

[38] Although the US has recently indicated an intention to incorporate some aspects of the twin peaks model into its new hybrid regulatory structure; see US Department of the Treasury, *The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure* (2008), available at <http://www.treas.gov/press/releases/reports/Blueprint.pdf>.

[39] Group of 30, *The Structure of Financial Supervision – Approaches and Challenges in a Global Marketplace*, 2008, 36.

[40] Donald C. Langevoort, "Global Securities Regulation After the Financial Crisis" (2010) 13 *Journal of International Economic Law* 799, 805; see also Michael W. Taylor, "The Road from "Twin Peaks" – and the Way Back" (2009) 16 *Connecticut Insurance Law Journal* 61, 89.

[41] C O'Faircheallaigh, J Wanna & P Weller, *Public Sector Management in Australia: New Challenges, New Directions* (1999), 21-4.

[42] Group of 30, above n39, 37.

However, there are some significant disadvantages inherent to a twin peaks approach. Unlike the integrated model, which has complete regulatory jurisdiction, in a twin peaks system this jurisdiction is shared by two regulators, whose individual jurisdiction will at times overlap. Similarly, the twin peaks model will often struggle to achieve streamlined regulation, due to the need for extra communication, whereas a single regulator can carry out all facets of the regulation necessary for any financial institution. This communication and coordination difficulty also makes it harder for a financial institution to receive tailored regulation under a twin peaks system. A twin peaks model will typically strive for certain efficiency due to both partial or overlapping regulation, and financial entities may find the regulation to be inconsistent between the two regulators in this regard.

It is fair to conclude, then, that some of the shortcomings in the Australian system are inherent in the twin peaks model itself, such as regulatory overlap, communication barriers, and lack of coordination between the regulatory bodies. Former ASIC Deputy Chairman Jeremy Cooper acknowledged that to function properly, the twin peaks model "requires a high level of commitment from both agencies...to achieve continuing 'real time' information sharing about emerging risks and mutual concerns".[43] ASIC and APRA have attempted to overcome this inherent difficulty by entering into memoranda of understanding, the most recent of which was signed in May 2010.[44] The current memorandum delineates the regulatory scope of each regulator, and recognises the need for cooperation and information sharing, stipulating methods by which this can be achieved. Overcoming the key difficulties in the twin peaks system is crucial, as facilitating information sharing will only be made more difficult as technology allows financial activities to become more internationalised. At the same time, information received internationally will become ever more important to effective regulation of local markets, because global markets are growing ever more influential locally.[45] It is clear that for the twin peaks model to continue its successful experience in Australia, a constant effort will need to be maintained to ensure that communication and cooperation between ASIC and APRA continues.

Part 2. The Office of "Trustee-Director"

The reform initiatives for the Australian superannuation industry proposed in the Cooper Review are far-reaching and have been closely scrutinised by the industry and regulators alike. Recommendation 2.1 of the Cooper Review proposes the creation of a new office of "trustee-director" under the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**). The proposal states that "all statutory duties" relevant to the new office will be "fully set out", and specifically mentions including those duties which would otherwise be found in the *Corporations Act 2001* (Cth) (**Corporations Act**). The Final Report continues that "trustee-directors should not have to collate rules from multiple

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[43] Australian Securities and Investment Commission, above n28, 14.

[44] Australian Securities and Investments Commission, *Memorandum of Understanding between the Australian Prudential Regulatory Authority and the Australian Securities and Investments Commission* (2010), available at <http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/MOU-APRA-and-ASIC-May-2010.pdf/$file/MOU-APRA-and-ASIC-May-2010.pdf>.

[45] See generally: Dr George Gilligan, "International Trends in the Regulation of the Financial Services Sector" (2002) 14 *Australian Journal of Corporate Law* 1.

sources in order to understand their core duties".[46] The intention of the proposal is to create a position, the duties of which can be found all in the one section without reference to any other legal provisions, be they statute or general law.

While this sounds admirable and would quite possibly be beneficial was it to actually occur in practice, the proposal appears to have overlooked some significant difficulties. The most obvious issue is that the proposed amalgamation of all required duties of the trustee-director in the SIS Act appears to be incomplete. The Final Report states that there is no intention to "codify common law principles",[47] and that ASIC will continue to regulate the office of trustee-director, presumably with the same power to prescribe regulatory obligations under the Corporations Act. It is proposed that the licensing requirements of financial product and financial service providers remain unchanged, and will continue to be found under Part 7.6 of the Corporations Act and Part 2A of the SIS Act. Finally, relevant State and Territory legislation may continue to apply to the trustee-director.[48]

It is difficult to see how the reshuffle of directors' duties from the Corporations Act to the SIS Act will have any discernible effect on the ease with which a trustee-director can place his or her hands on the duties applicable to the position. The stated purpose of the reform, which is to create "unambiguous clarity about the duties owed by the trustee-directors",[49] seems unlikely to result without considerably more reformation to the obligations which directors of trustee companies are currently obliged to fulfil. This likely comes from the idea expressed in the Final Report that "the regulatory scheme shaping the governance of superannuation funds is unnecessarily complicated".[50] Complicated, perhaps; but not unnecessarily so.

The Final Report identifies as an aspect of the complication the fact that the regulatory scheme "operates at two levels: one for trustees and a second for trustee-directors".[51] That statement reflects a misunderstanding of the often complex legal duality inherent in the position of the director of a trustee company. This legal duality may appear odd to the layperson, but familiar examples abound in the law such as legal and equitable title of property and the distinction of a corporation as both a legal identity and as its organs. Further, the Final Report misrepresents the obligation placed upon directors by s 52(8) of the SIS Act. It states that the section imposes the covenants upon the directors of the trustee company "as though they were the trustees personally",[52] but with all due respect, this is incorrect. The directors are not obliged to fulfil the covenants, but to simply "exercise a reasonable degree of care and diligence for the purposes of ensuring" **the trustee** carries out the covenants.[53]

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[46] Commonwealth of Australia, above n22, 46.

[47] Ibid, 47.

[48] For example, *Trustee Act 1925* (NSW), ss 14A, 14C.

[49] Commonwealth of Australia, above n22, 46.

[50] Ibid, 47.

[51] Ibid.

[52] Ibid.

[53] SIS Act, ss 52(8), 52(9); P Hanrahan, "Directors' liability in superannuation trustee companies" (2008) 2 *Journal of Equity* 204, 210.

Also of concern is that the change of location for the duties of a trustee-director is more than a mere transplant from the Corporations Act. The Final Report has recommended a distinctly new set of duties, and although some may sound superficially similar to those in the Corporations Act, they will likely result in an entirely new set of obligations. Because of the extensive changes, current jurisprudence will likely apply only in a limited fashion, if at all. That means that these proposed new obligations will require fresh judicial and academic discourse to clearly define their scope, and until such time has elapsed, considerable confusion about the scope of the proposed duties is likely to remain. Recent history provides us with numerous examples of this occurring after extensive legislative change.[54] The Final Report itself noted that it "is conscious of the consequences in terms of delay, cost and disruption, that legislative changes such as this cause", but continues that it considers the changes to be necessary steps towards a "more accountable and efficient trustee governance regime".[55] It is difficult to see how the proposed new office of trustee-director and the duties which attach to the role would enhance accountability and efficiency in practice.

Part 3. Consequences of Prescriptive and Proscriptive Duties

There is also a concern that the prescriptive regime of positive duties recommended in the Final Report will be in direct conflict with the proscriptive regime of fiduciary obligations incumbent upon both directors and trustees under the general law. It is arguable that after *Breen v Williams*[56] and *Pilmer v Duke Group Ltd*[57] the traditional view of fiduciary obligations having a proscriptive nature is correct in Australia. This notion was first developed by Finn in 1988,[58] where he argued that the content of fiduciary duties could be expressed exhaustively in two proscriptive obligations: the "no conflict rule" and the "no profit rule".[59] The High Court confirmed Finn's theory in *Breen* and *Pilmer*, and in addition to recently being confirmed by Owen J in *Bell*,[60] the idea has received support outside of the courts.[61] Though some commentators do not accept that there can be no prescriptive fiduciary obligations, particularly regarding the good faith and proper purposes duties in the director/company relationship,[62] it seems a

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[54] Indeed, the introduction of the *Financial Services Reform Act 2001* (Cth) in March 2002 with a 2 year transition period fundamentally changed the conduct, licensing and disclosure rules for financial services entities in Australia. These rules under the financial services reform (**FSR**) regime continue to evolve with a number of legislative refinements and there is considerable doubt about the scope of many of the FSR rules.

[55] Commonwealth of Australia, above n22, 46.

[56] (1996) 186 CLR 71.

[57] (2001) 207 CLR 165.

[58] P D Finn, "The Fiduciary Principle" in T G Youdan (Ed), *Equity, Fiduciaries and Trusts* (1989), 1.

[59] These duties are well established; see for example *Phipps v Boardman* [1967] 2 AC 46 and *Chan v Zacharia* (1984) 154 CLR 178.

[60] *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* (2008) 225 FLR 1, [4552] per Owen J.

[61] R P Austin, 'Moulding the Content of Fiduciary Duties' in A J Oakley (Ed), *Trends in Contemporary Trust Law* (1996), 159; G Dempsey & A Greinke, "Proscriptive Fiduciary Duties in Australia" (2004) 25 *Australian Bar Review* 1, 3.

[62] See for example J D Heydon, "Are the Duties of Company Directors to Exercise Skill and Care Fiduciary?" in S Degeling and J Edelman (Eds), *Equity In Commercial Law* (2005), 233.

reasonable conclusion to draw that at least in general, fiduciary duties in Australia "are essentially proscriptive" in nature.[63]

This being the case, there is a danger that the trustee-director will be placed in a very difficult position in the event of a conflict. The prescriptive regime requires trustee-directors "to act solely for the benefit of members",[64] which includes and particularises six requirements. Recommendations 2.1(a)(iii – vi) appear to be restatements of either general law fiduciary obligations owed by trustees and directors of trustee companies under the general law, which are typically cast in proscriptive terms, or duties owed under the Corporations Act (although, as mentioned above, the precise obligations owed in the new regime would still need to be interpreted). The remaining two requirements are novel. Recommendation 2.1(a)(i) requires the trustee-directors to "avoid putting themselves in a position where their interests conflict with members' interests", and Recommendation 2.1(a)(ii) requires priority to be given to their duty to members "when that duty conflicts with the duty owed to the trustee company, its shareholders, or any other person". This is in direct opposition to the general law requirement of a director to place the interests of the company above all others. It is clear that such an inconsistency could only result in the general law not applying to directors in the special case of a superannuation trustee company, despite the apparent intention not to remove the application of the common law.[65]

Although the precise terminology is not used in the Final Report, the "enhanced" directors' duties under Recommendation 2.1 have the potential to amount to a statutory imposition of a fiduciary relationship between directors and members of a superannuation fund. A fiduciary relationship has never been imposed lightly by the Australian courts. In *Breen v Williams*[66] Gaudron and McHugh JJ quoted with approval the warning given by Sopinka J in *Norberg v Wynrib*,[67] saying that "fiduciary duties should not be superimposed on these common law duties simply to improve the nature or extent of the remedy". This approved the earlier sentiment of Finn J in *ASC v AS Nominees*,[68] in which his Honour considered, inter alia, whether a fiduciary duty existed between the trustee-directors and the beneficiaries of superannuation trusts. His Honour noted that the idea was "not without its critics", and was of the opinion that "protection [for the beneficiaries] can be afforded by other quite orthodox means and in a more extensive way".[69]

The imposition of a fiduciary relationship may be appropriate as a remedy, but it may well be completely unworkable in practice. Although the Final Report recommends removing the application of the directors' duties under Part 2D.1 of the Corporations Act,

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[63] R C Nolan, "The Proper Purposes Doctrine and Company Directors" in B Rider (Ed), *The Realm of Company Law* (1998), 12.

[64] Commonwealth of Australia, above n22, 48.

[65] Ibid.

[66] (1996) 186 CLR 71, 110.

[67] (1992) 92 DLR (4th) 449, 481.

[68] (1995) 133 ALR 1.

[69] *ASC v AS Nominees* (1995) 133 ALR 1, 18.

directors will still owe a fiduciary duty to their company under the general law.[70] Trustee-directors will therefore owe a duty to both the beneficiaries of the trust (i.e. members of the fund) and the company to act in their best interests respectively. These duties may not always align and it is easy to envisage how they could come into direct conflict, such as when a trustee board is dealing with the distribution of a surplus, or where it is considering questions of remuneration for its directors.

Part 4. A Code of Trustee Governance

Recommendation 2.18 of the Cooper Review proposes the development of a Code of Trustee Governance for trustees of superannuation funds.[71] This would be developed in consultation with an industry council coordinated by APRA, with the aim of identifying the best practice in the industry.[72] The recommended content of the code includes:

- A higher standard of competence for the chair of the board;
- A recommended retirement age, required skill set, ongoing training requirements, gender diversity, and number of board members;
- A review of director skill set after 12 months, and general annual performance review.[73]

Recommendation 2.20 also proposes an annual comparative review of the trustee's performance with the requirements of the Code of Trustee Governance to be made available on the fund's website.[74] Both recommendations have received in principle support from the Government.[75]

The motivation behind the implementation of a Code of Trustee Governance is the opinion that superannuation funds "demand a higher level of governance than that appropriate for members of major listed entities".[76] The Cooper Review also states that "broad equitable principles are not sufficiently targeted to meet the needs of a multi-trillion dollar" system, opining that such "19th century principles" have "become a relatively ineffective mantra".[77] With respect, this disparagement of equitable principles is unwarranted, as the trust system in which superannuation funds exist is, after all, based heavily upon these very same equitable principles. Also, the proscriptive nature of the equitable rules allows for the flexibility required to "keep pace more easily with changes in the industry",[78] which is the very reason given for the proposed introduction of the Code. The standards envisioned by the code will necessarily be prescriptive in nature, which, ironically, considering the objective of the Cooper Review, can often be

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[70] See for example *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41, 96-7 per Mason J.

[71] Commonwealth of Australia, above n22, 64.

[72] Ibid.

[73] Ibid.

[74] Commonwealth of Australia, above n22, 65.

[75] Commonwealth of Australia, above n27, 29-30.

[76] Commonwealth of Australia, above n22, 62.

[77] Ibid, 63.

[78] Ibid.

more inflexible than proscriptive requirements. This concern was recently flagged by the Corporations and Markets Advisory Committee (**CAMAC**) in the context of company directors. CAMAC stated in a recent report that “there is an important line between prescription – the laying down of standards that must be followed – and guidance – the offering of approaches and forms of behaviour to help directors in carrying out their role”.[79] Likewise in the Royal Commission into the HIH collapse, Owen J said that the concepts of corporate governance “do not lend themselves easily to specification in something such as a code of best practice”.[80]

The author is of the opinion that while introducing a code in and of itself is to be applauded,[81] the currently proposed code might not achieve its stated goal of reflecting “the unique context of a superannuation fund”.[82] In its current form, the proposed code mostly sets structural requirements of the board, which will arguably render little substantive change to the functioning of trustee boards and the activities of their directors in the superannuation industry. Further, the goals of the code regarding the skill set of directors would likely be far better effected by adopting a proscriptive standard than a prescriptive standard, if for no other reason that that the former is easier to enforce. Adopting a mandatory training system similar to that used in Ireland or the UK would have the benefit of preserving the decentralised nature of trustee education, and at the same time remain proscriptive in that if trustees fail to complete the required education they become ineligible to continue as members of a trustee board. Setting a prescriptive regime of education and skill requirements, which the proposed code seems to be advocating, is perhaps not the most appropriate manner of achieving enhanced competency amongst superannuation trustee boards and their directors.

Part 5. What should financial services regulation look like in Australia?

Whatever appearance the future regulatory landscape has, it will need to be carefully planned and executed to achieve the desired effect. Obviously the management of $1.23 trillion in assets (in the superannuation industry alone)[83] requires a system which has, and is seen to have, “high standards of governance” to ensure investor confidence, and clearly adequate regulation is a key factor in achieving this goal.[84] The question which needs to be considered before these reforms are implemented is whether the current proposals will achieve this objective, or will merely become another confusing and frustrating layer of regulation with which directors and trustees need to comply. It has long been a complaint that the outcomes of financial reform legislation are too often not the same as the objectives of the reformers, and that the reason for this is the failure to appreciate the “interface” between the objectives and the legislative process which

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[79] Corporations and Markets Advisory Committee, *Report: Guidance for Directors* (2010), 79.

[80] Commonwealth of Australia, HIH Royal Commission, *The Failure of HIH Insurance: Volume 1 – A Corporate Collapse and its Lesson* (2003), 133.

[81] Note many examples already exist within the industry: see for example Association of Superannuation Funds of Australia, *Best Practice Papers Series*, available at <http://www.superannuation.asn.au/Best-Practice-Series/default.aspx>.

[82] Commonwealth of Australia, above n22, 62.

[83] Australian Prudential Regulation Authority, *Statistics - Annual Superannuation Bulletin June 2010* (2011), 5.

[84] Commonwealth of Australia, above n22, 44.

achieves them.[85] This may explain the enthusiastic legislative effort which has led to the arguably excessive number of regulators in the financial services arena.[86] This was acknowledged in the Wallis Report in 1997,[87] which recommended that "regulation should be revised and reconfigured so as to promote competition without compromising economic stability".[88] The guiding principle followed was that by providing consistent regulation and regulatory treatment for financial products and services, greater competition would be generated amongst providers through lower costs and more readily understood regulatory obligations.[89] The clearest manifestation of these sentiments is found in the introduction of the FSR regime in Chapter 7 of the Corporations Act following the Wallis Report.[90] It is to be hoped that whatever the state of future regulation in the financial industry, it exists as it was envisioned at its implementation.

It is a reasonable conclusion to draw that future regulation will likely remain based on the twin peaks model. A recurring theme in the submissions evaluated by the Cooper Review is that being regulated by two regulators is currently trying, confusing, and inefficient, yet the same submissions rarely advocated that the Twin Peaks system be abandoned and merged into a single regulator.[91] Instead, the submissions often called for a "front of shop" type system, where ASIC and APRA would either share a site, or at least share a reception of some kind, where regulatees could submit information to both regulators through one portal.[92] This would have the distinct advantage of eliminating the confusion and inefficiency of complying with two sets of often similar regulation, and also would dramatically reduce compliance costs in the form of time and administration. It is important to remember that even integrated regulatory systems are generally departmentalised into prudential and market regulatory segments, particularly so when the financial markets being regulated are very large.[93] Communication and coordination in a large integrated regulatory entity can therefore often become as difficult to maintain as in a twin peaks system. Another reason for the likely future retention of the twin peaks system in Australia is that it is the culmination of over 20 years of reform and refinement. As the recent submissions to the Cooper Review have suggested, there may be some irritation within particular industries regarding specific regulation, but there does not appear to be any dispute with the fundamental structure which has resulted from Australian financial reform.

It is also very likely that future regulation, if the twin peaks system remains in place, will remain divided upon the regulatory functional lines of prudential management and

[85] J Batten & C Kearney, "Legislating Financial Reform: The Australian Experience" (1998) 8 *Australian Journal of Corporate Law* 300, 300.

[86] Adams, above n11, 2.

[87] Above n4.

[88] I Harper, "The Wallis Report: An Overview" (1997) 30(3) *Australian Economic Review* 288, 288-9.

[89] Ibid, 296.

[90] Association of Superannuation Funds of Australia Limited, above n34.

[91] Investment & Financial Services Association Ltd, above n23, 16; ibid, 22-23.

[92] Commonwealth of Australia, above n22, 308-309.

[93] Group of 30, above n39, 36.

regulation of market conduct, also known as objectives-based regulation. The practice of dividing regulation according to business type has become more difficult, as so many of the larger financial services entities now offer a range of services. Attempting to divide regulation along the lines of a business model can also lead to regulatory fragmentation, which when uncoordinated, can lead to a complete regulatory breakdown.[94] The US experienced this during the recent global financial crisis, although it is arguable that it was the statutory disassembly of the strength of the regulatory system itself which was equally to blame for the ultimate breakdown.[95] Whatever the cause, the US now plans to adopt an objectives-based regulatory structure loosely based on the Australian model.[96] It is therefore a fair assumption that the objectives-based regulatory model will be preserved in Australia, at least in the near future.

Regardless of the structure adopted by the Australian financial regulatory system in the future, it should contain certain minimum qualities. It must be efficient, meaning that it regulates the financial sphere without unnecessary inefficiency, such as the cumbersome and often confusing dual regulation that is currently suffered particularly by entities in the superannuation industry. It must be effective without being a hindrance, meaning that the financial industry operates within prudently defined boundaries, but is not regulated to the point where operation becomes difficult. Finally, it must be tailored to the industry. This is best achieved via extensive consultation with industry to decide which regulation is necessary and which is simply burdensome, and the measures which need to be implemented to achieve that regulation. Whatever the model of regulation, if it bears these qualities, it will likely be a regulatory model which can carry the Australian financial sector comfortably into the future.

[94] See for example: Taylor, above n40, for an account of regulatory fragmentation which ultimately led to a breakdown in the US.

[95] Renee M Jones, "Back to Basics: Why Financial Regulatory Overhaul is Overrated" (2010) 4 *Entrepreneurial Business Law Journal* 389, 395.

[96] US Department of the Treasury, above n38.